FTC/DOJ Workshop on the Horizontal Merger Guidelines

Firms that Participate Through a Supply Response: Uncommitted Entry

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An important principle in writing or revising antitrust enforcement guidelines should be "do no harm"

- This is especially true for guidelines that are generally considered to be successful, as is the case with the Merger Guidelines
- Revisions are sometimes justified – to better reflect actual enforcement policies (arguably needed for the HHI-based presumptions); to expand on existing themes (as with the efficiencies revisions in late 1990s); or to address additional issues (vertical mergers?)
- Revisions designed to fix one perceived problem can create other problems – if for no other reason than that new verbiage is created, requiring a new cycle of application and interpretation before there is a consensus about what it means
- If the worst thing that can be said of a portion of the Merger Guidelines is that it is seldom used in practice, that does not necessarily mean it needs to be changed or abandoned
- The uncommitted entry section does add value in some cases

e *Is the Guidelines' analysis of uncommitted entry economically sound?*

- No one seems to challenge the fundamental economic analysis, which is as economically solid as any aspect of the Guidelines. The introduction of a serious consideration of sunk costs in the analysis of supply elasticity was a significant contribution to the Guidelines in the early 1990s

- Critiques of the uncommitted entry analysis focus on the infrequency in which the necessary conditions for its applicability are met, and on questions about the relevance of distinctions between committed and uncommitted entry

- There are legitimate questions about aspects of the uncommitted entry analysis. For example, firms may typically be more likely to affect prices in the relevant market if incumbents view them as not only likely to enter readily in response to a SSNIP but also, having entered, as likely to remain in the market. These are fair points and could warrant a look at some refinements to the Guidelines

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Is that analysis ever useful as a practical matter? Not often, for several reasons

- It is primarily aimed at cases in which the number of market participants and their shares are important, applying a coordinated interaction theory. But in such cases market concentration and shares are only a starting point – so the complex analysis required to identify and assign shares to uncommitted entrants will seldom be decisive

- Significant sunk costs of entry are usually present in the types of markets in which antitrust concerns are plausible. This is often due less to impediments to "swing production" than to post-production factors noted in the Guidelines: the need to achieve customer acceptance, develop distribution, etc. In these types of markets, uncommitted entry may have little impact

- The analysis relies on line-drawing that is inherently somewhat arbitrary – supply responses must take place within one year, and "significant sunk costs" are those that would not be recouped within a year. Yet line-drawing occurs throughout the Guidelines (two years for new entry; the HHI thresholds; the market share indicators for unilateral effects), and while in the absence of these indicators the Guidelines might be more analytically correct, they would provide less guidance

- The entry analysis in Section 3 of the Guidelines may suffice in most instances when supply responses are relevant

e *Is that analysis ever useful as a practical matter? Yes, in some cases*

- As noted above, even if the analysis is applicable in only a limited number of instances, that alone may not be sufficient reason to alter or abandon it
- There have been a number of cases in which an assessment of uncommitted entry/supply responses was important – case involving price discrimination markets; unilateral effects cases where competitor repositioning is relevant; cases in industries where “swing” capacity and production is a central feature of the industry; and cases involving the role of imports

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Is that analysis ever useful as a practical matter? Yes, in some cases -- imports

- The uncommitted entry analysis applies not only to supply responses from outside the product market, but it also to new sources of supply from outside the geographic market. Cases where the significance of imports is important may lend themselves well to the uncommitted entry analysis

- The concept of “hit and run” supply that can be done quickly and with relatively low sunk costs can be particularly useful in examining the role of imports

- A typical scenario involves a market that is defined regionally based on demand characteristics (*e.g.* a U.S. market, based on differentiated requirements of U.S. customers), but where imports “swing” into the region in response to market conditions. In such cases imports will not always register as significant on a current-sales-share basis if recent market conditions have not so warranted

- While one could choose to view market shares over a longer time period in order to pick up the existence of imports in the past, or could simply look at importers under the analysis of new entry in Section 3 of the Guidelines, the existing Guidelines analysis of uncommitted entry can be instructive in cases like this

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Is that analysis ever useful as a practical matter? Yes, in some cases – unilateral effects

- The unilateral effects analysis (Section 2.21) asks whether the merging firms are each other's closest competitors, and whether "repositioning of the non-parties' product lines to replace the localized competition lost through the merger [is] unlikely." The timing and likelihood of repositioning is analyzed using either the uncommitted or committed entry analysis, depending on the significance of the sunk costs involved (fn. 23)

- As transactional data are increasingly available in many industries, unilateral effects investigations sometimes focus on the competitive proximity of the merging firms as measured by econometric analysis of these data

- But a threshold finding of competitive "closeness" based on relatively static transactional data requires that we proceed to the next step and examine supply responses – whether rival sellers are likely to "replace any localized competition lost through the merger by repositioning their product lines"

- In these cases, the uncommitted entry analysis may be quite useful. Repositioning by other suppliers whose products are at present somewhat distant in product space from the merging firms' products can in some cases occur relatively quickly and without high sunk costs (though most such costs, even if not high, are likely to be sunk)

- We could apply a single entry analysis in such a case, without distinguishing between committed and uncommitted entry. But the new entry analysis does not appear to fit such a case as well as the uncommitted entry analysis

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Are there reasons to keep the existing Guidelines analysis of uncommitted entry more or less intact?

- The key principle of enforcement guidelines noted at the outset – do no harm – suggests that we avoid unnecessary changes to existing guidance, as long as it is analytically sound and provides a useful framework in at least some cases

- There are some types of cases in which the uncommitted entry analysis adds value, although aspects of that analysis might be improved or refined